

INTERIM AUDIT REPORT ON
IMPROPER OBLIGATIONS USING
THE IRAQ RELIEF AND
RECONSTRUCTION FUND
(IRRF 2)

SIGIR-06-037
SEPTEMBER 22, 2006

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SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

September 22, 2006

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER),
U.S. DEPARTMENT OF DEFENSE
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
U.S. AMBASSADOR TO IRAQ
COMMANDING GENERAL, MULTI-NATIONAL FORCE-
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COMMANDING GENERAL, U.S. ARMY CORPS OF
ENGINEERS
DIRECTOR, IRAQ RECONSTRUCTION MANAGEMENT
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COMMANDING GENERAL, GULF REGION DIVISION,
U.S. ARMY CORPS OF ENGINEERS

SUBJECT: Interim Audit Report on Improper Obligations Using the Iraq Relief and Reconstruction Fund (IRRF 2) (SIGIR-06-037)

Due to the time-sensitive nature of the matter discussed in this report we are providing this interim audit report for your information and use. We performed this review in accordance with our statutory duties in Public Law 108-106, as amended, which mandates the independent and objective conduct of audits relating to the programs and operations funded with amounts appropriated or otherwise made available in support of Iraq relief and reconstruction.

Objective

This review was announced on July 21, 2006, with the overall objective of determining the amount of Iraq Relief and Reconstruction Fund (IRRF) unmatched disbursements, and whether the U.S. Government agencies have established adequate management controls over IRRF unmatched disbursements. During our review of unmatched disbursements we found 96 obligations totaling about \$362 million that described the vendor name as "Dummy Vendor". The term "Dummy Vendor" was used in the U.S. Army Corps of Engineers Financial Management System to allow entering data into a data field for vendors when no specific vendor existed. We do not believe in using this term there was any attempt to mislead on the true status of obligations. The U.S. Army Corps of Engineers has since changed this terminology from "dummy vendor" to "IRRF in-scope modifications and estimate cost-to-complete projects" to more accurately reflect their purpose for the obligations.

The objective of this interim audit was to assess whether these obligations of IRRF funds initially noted as "Dummy Vendor" met the criteria for proper obligations.

Background

In November 2003, Congress passed Public Law 108-106, the Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, which appropriated \$18.4 billion for the rebuilding of Iraq. This money is known as the Iraq Relief and Reconstruction Fund 2 (hereafter referred to as IRRF 2).¹ The funds provided in Public Law 108-106 were to remain available until September 30, 2006. Therefore, the authority to initially obligate these funds will expire on that date. According to the financial records of the U.S. Army Corps of Engineers (USACE) Finance Center, as of August 24, 2006, the Department of Defense (DoD) has about \$464 million remaining in IRRF 2 to obligate by September 30, 2006, as detailed in the Corps of Engineers Financial Management System (CEFMS) report of all DoD IRRF 2 obligations and disbursements allocated to DoD.

Results

Our review of the Project and Contracting Office obligations recorded in USACE's financial records determined that the \$362 million recorded under the vendor name as "Dummy Vendor" do not constitute proper obligations. The establishment of these obligations is not consistent with a 1995 decision by the Comptroller General of the United States on appropriations availability, the U.S. Government Accountability Office's (GAO) Appropriations Law Manual, and the DoD Financial Management Regulation (FMR) requirements for the recording and reviewing of commitments and obligations. If action to obligate these funds consistent with GAO and DoD guidance on what constitutes proper obligations is not taken by September 30, 2006, they will expire. As a result, USACE actually over reported its obligations by \$362 million so it really had as of August 24, 2006, \$826 million remaining to obligate by the end of the fiscal year.

Guidance Exists on Availability and Recording of a Proper Obligation

The Comptroller General of the United States, GAO's Appropriations Law Manual, and the DoD FMR provide guidance on what constitutes a proper obligation. According to the GAO Appropriations Law Manual, Chapter 7, an "obligation" is some action that creates a liability or definite commitment on the part of the government to make a disbursement at some later time. In a 1995 decision² the Comptroller General stated that it is a fundamental principle of appropriations law that appropriated amounts are limited for obligation to a definite period and are available only for payment of expenses properly incurred during that period of availability. The Comptroller General further stated that unless properly obligated during their period of availability, any amounts reserved in a contingency account would not be available to support obligations arising after the expiration of their period of availability.

This decision is discussed in detail in GAO's Appropriations Law Manual, Chapter 5.³ The manual states: "An appropriation may not be used for the needs of some time period subsequent to the expiration of its period of availability." With respect to annual appropriations, a more common statement of the rule is that an appropriation for a given

¹ P.L. 108-11 established the \$2.48 billion Iraq Relief and Reconstruction Fund 1 (IRRF 1). The scope of this report does not include IRRF 1 funds.

² *Comp. Gen. Dec. No. B-257061, 1995, Matter of Federal Aviation Administration -- Appropriations availability -- Payments of Attorney's Fees.*

³ U.S. Government Accountability Office, *Principles of Federal Appropriations Law: Third Edition, Volume 1*, GAO-04-261SP, January 2004. The document was last updated on June 9, 2005.

fiscal year is not available for the needs of a future fiscal year.” IRRF 2 is a multiple-year appropriation (Fiscal Years 2004-2006), and apart from the extended period of availability, multiple-year appropriations are subject to the same principles applicable to annual appropriations.

Regarding recording of obligations, DoD’s FMR, 7000.14R, Volume 3, Chapter 8, states that obligations shall be recorded in the official accounting records at the time a legal obligation is incurred, or as close to the time of incurrence as is feasible. An amount shall be recorded as an obligation only when supported by documentary evidence of the transaction.

Some IRRF 2 Obligations Recorded In CEFMS Do Not Constitute Proper Obligations

In reviewing the August 24, 2006, CEFMS report of all IRRF 2 obligations and disbursements allocated to DoD, we identified 96 obligations totaling about \$362 million that described the vendor name as “Dummy Vendor”. These obligations, recorded between November 2004 and August 2006, were identified within five categories in the CEFMS report, as shown in table 1. None of these obligations identified a vendor or contractor by name, nor had any disbursements been made against them. When we discussed these obligations with the Deputy Director of USACE’s Finance Center on August 25, 2006, she queried the USACE’s Gulf Region Division-Project and Contracting Office. The Gulf Region Division Deputy Director for Finance advised the USACE Finance Center that these are miscellaneous obligation documents set up by the Project and Contracting Office within IRRF 2 and that a formal request for legal review is being prepared to formalize USACE’s authority to keep these miscellaneous obligation documents on the books.

Table 1: IRRF 2 Obligations Described in CEFMS Under “Dummy Vendor” Accounts

| Type of Obligation | Number of CEFMS Entries | Amount Obligated (\$ in millions) | Amount Disbursed (\$ in millions) |
|--------------------------------|--------------------------------|--|--|
| Contingency | 30 | \$ 252.2 | \$ 0 |
| Design/Build Program Close Out | 25 | 85.1 | 0 |
| Public Works Center Costs | 36 | 19.4 | 0 |
| Supervision & Administration | 2 | 0.3 | 0 |
| Claims & Unknown | 3 | \$ 5.5 | 0 |
| Total | 96 | \$362.5 | \$ 0 |

Source: Developed by SIGIR from CEFMS data as of August 24, 2006.

As shown in Table 2, these obligations cover 9 construction and non-construction sectors relating to the Iraqi economy. The bulk of them—69%—are in the oil and electricity sectors.

Table 2: IRRF 2 Obligations with Vendor Name of “Dummy Vendor” by Sector

| Sector | Number of Entries | Amount Obligated (\$ in millions) | Percent of Total “Dummy Vendor” Obligations |
|---|--------------------------|--|--|
| Security & Law Enforcement | 3 | \$2.5 | .7 |
| Justice, Public Safety Infrastructure & Civil Society | 22 | 29.0 | 8.0 |
| Electricity | 16 | 129.6 | 35.8 |
| Oil Infrastructure | 8 | 119.4 | 32.9 |
| Water Resources | 21 | 55.7 | 15.4 |
| Transportation & Telecommunications | 12 | 5.3 | 1.5 |
| Roads, Bridges & Construction | 9 | 8.8 | 2.4 |
| Health Care | 4 | 12.1 | 3.3 |
| Education, Refugees, Human Rights & Governance | 1 | .1 | 0 |
| Total | 96 | \$362.5 | 100.0 |

Source: Developed by SIGIR from CEFMS data as of August 24, 2006.

On September 7, 2006, we discussed these results with the USACE Chief Financial Officer (CFO), the command’s senior fiscal official. In response to our concerns that the current obligations identified under “Dummy Vendor” are not proper obligations, the CFO stated that he is in the process of taking several actions. Specifically, the CFO informed us that he:

1. formally requested, on September 6, 2006, a legal opinion from the Army Deputy General Counsel (Ethics and Fiscal) on USACE’s plan to reserve funds appropriated for IRRF for in-scope modifications and close-out costs
2. initiated discussions with the Office of Management and Budget to determine the validity of this method of reserving and recording IRRF 2 funds
3. plans to initiate discussions with the Department of State, which is responsible for managing IRRF

We believe given that these recent or planned actions only began on September 6, 2006, there is a high risk that this issue will not be resolved before the authority to obligate IRRF 2 funds expires on September 30, 2006.

Conclusion

The obligation of amounts from IRRF 2 must be made for *bona fide* purposes prior to September 30, 2006. Appropriated amounts are limited for obligation to a definite period and are available only for payment of expenses properly incurred during that period. Thus, unless obligated consistent with GAO and DoD guidance on what constitutes proper obligations during their period of availability, any amounts reserved as a contingency would not be available to support obligations arising after expiration of their period of availability. Consequently, we have concluded that the \$362 million recorded in CEFMS as “Dummy Vendor” are not proper obligations of IRRF funds. Further, if these funds are not obligated against discrete contracts (or other recordable transactions) consistent with GAO and DoD guidance on what constitutes proper obligations, the authority to obligate them will expire on September 30, 2006.

We further believe that including the \$362 million of improper IRRF obligations in the CEFMS official accounting records has resulted in inaccurate reporting to Congress on the amount of IRRF funds obligated and the funds remaining to be obligated. Consequently, DoD management and Congress are not receiving accurate information on IRRF.

Recommendation

We recommend that the Commanding General, USACE, direct the Gulf Region Division-Project and Contracting Office to immediately review the 96 obligations established for “dummy vendors,” and to the extent practicable, take steps to obligate these funds consistent with GAO and DoD guidance on what constitutes proper obligations by September 30, 2006; or alternately take steps to assure that the funds remain legally available.

Management Comments and Our Response

Because of the time sensitive nature of this report we obtained formal oral comments from USACE. We discussed the finding with the USACE CFO, the command’s senior fiscal official, in an exit conference on September 12, 2006. USACE’s CFO agreed with our conclusion that the \$362 million in IRRF 2 funds obligated without a vendor name were not proper obligations. USACE is seeking a solution that meets its needs to fund future contingency and close-out costs in a manner that constitutes proper obligations.

On September 18, 2006, the USACE CFO provided an additional response. According to the CFO, the USACE will recommend that the Project and Contracting Office deobligate these funds immediately and return the funds to the Department of the Army. The CFO IRRF worksheet identified about \$348 million to be de-obligated. USACE will let these funds expire on September 30, 2006 under their agency code and will maintain these expired funds for in-scope modifications in Fiscal Year 2007.

Guidance Exists on the Use of Expired Funds

Once the initial period for which an appropriation is available expires, the availability of any remaining balances for further obligation is limited. GAO’s Appropriations Law Manual provides guidance on disposition of appropriation balances. An annual appropriation that is un-obligated at the end of the fiscal year for which it was appropriated is said to “expire” for operational purposes. In other words, they cease to be

available for the purposes of incurring and recording new obligations. The same principle applies to multiple year appropriations as of the end of the last fiscal year for which they were provided. Upon expiration of a fixed appropriation, the obligated balances retain their fiscal year identity in an “expired account” for that appropriation for an additional five fiscal years.⁴ During the five year period, the expired account balance may be used to liquidate obligations properly chargeable to the account prior to its expiration. The expired account balance also remains available to make legitimate obligations adjustments, that is, to record previously unrecorded obligations and to make upward adjustments in previously under recorded obligations.⁵

Scope and Methodology

This review was announced on July 21, 2006 (Project No. 6027), with the objective of determining the amount of IRRF unmatched disbursements, and whether the U.S. Government agencies have established adequate management controls over IRRF 1 and IRRF 2 unmatched disbursements. We conducted this review at the USACE Finance Center in Millington, Tennessee, and USACE headquarters in Washington, D.C.

In the course of examining IRRF 2 unmatched disbursements, we obtained and reviewed the USACE Finance Center’s August 24, 2006, report of all IRRF 2 obligations and disbursements allocated to the DoD which was generated from CEFMS. During our review of the CEFMS report, we identified 96 obligations totaling about \$362 million that described the vendor name as “Dummy Vendor”.

To determine the basis for the entry of the 96 obligations into CEFMS, we held discussions with Finance Center personnel. In responding to our questions about the “Dummy Vouchers” the Deputy Director of the Finance Center queried USACE’s Gulf Region Division-Project and Contracting Office in Baghdad. We also discussed the basis for these obligations with senior USACE resource management officials, including USACE’s CFO. To determine whether these obligations were proper, we reviewed Comptroller General of the United States decisions, GAO’s Appropriations Law Manual, and the DoD FMR to identify what constitutes a proper obligation.

We performed this review from July 21, 2006 through September 20, 2006, in accordance with generally accepted government auditing standards.

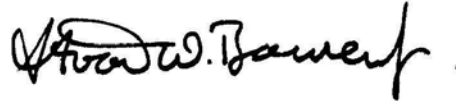
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This interim report is provided for management’s use and appropriate action, and is consistent with the information discussed at our meetings held on September 12 and 18, 2006, with the USACE CFO. No response to this interim report is required, but we will follow-up on the recommendations made as we continue our audit.

⁴U.S. Government Accountability Office, *Principles of Federal Appropriations Law: Third Edition, Volume 1*, GAO-04-261SP, January 2004. See pp. 5-72.

⁵ Ibid

We appreciate the courtesies extended to the staff. For additional information on this interim report, please contact Mr. Joseph T. McDermott ([703-604-0982](tel:703-604-0982) / joseph.mcdermott@sigir.mil); or Mr. Steve Sternlieb (703-428-0240 / steven.sternlieb@sigir.mil).

A handwritten signature in black ink, reading "Stuart W. Bowen, Jr." with a period at the end. The signature is written in a cursive, flowing style.

Stuart W. Bowen, Jr.
Inspector General

cc: See Distribution

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